

In connection with their audit of the 2005 financial statements of the Town of Harpswell, Runyon, Kersteen, Ouellette made a number of comments and suggestions regarding opportunities for strengthening internal controls and operating efficiency. These comments were contained in a letter report dated January 20, 2006 which is on file at the Town offices. The comments are reproduced below and are followed by the responses of the Town.

Schedule of Comments

On-line receipting system: The on-line receipting system currently being used by the Town allows for the entering of a collection as either a “cash” transaction or a “check” transaction. We noted that this feature was not always being used. As a result, at the time of cash up, it was not known exactly how much cash should be expected versus how much of the receipts were represented by checks. Using this feature can both simplify the cash up process as well as ensure a proper audit trail is maintained of the actual transaction.

Additionally, it was noted that although the “cash” versus “check” feature was part of the software, the actual reports that were used to prepare the deposit did not provide a total of the cash versus checks. This results in unnecessary manual work. We would recommend the Town contact the software vendor and determine what modifications need to be made so that these totals will print on the reports.

Response: We agree that the ability to prove that daily deposits have been made intact is vital to the Town’s internal controls. We contacted our software vendor and the program changes necessary to accomplish this have been made. We have emphasized to our cash handlers the importance of using the software to distinguish between cash and checks. An employee has been assigned the task of preparing a simplified worksheet specifically for the Tax Office that will help them in proving the cash and check components of their deposits.

Transaction responsibility: One feature that strengthens internal controls is the ability to assign responsibility for a given transaction to a particular employee. The system provides for this by requiring the employee to enter their initials when processing the transaction. As a result, reports can be run when the deposit is being prepared *by employee*, to ensure that individually, as well as collectively, the work proves to the funds in the cash drawers. Our only concern in this area is that it does not appear that the system has a control that would prevent one employee from entering the initials of another employee when typing in a transaction. Although passwords are required to access the software initially, there is no password control at the step of entering the initials.

Response: We do not believe there to be a particularly high risk to the Town resulting from this situation. We have, however, discussed this with each employee who enters cash receipts into the Town’s accounting system and emphasized they are to use only their own initials when entering transactions. This resulted in a change in procedure with regard to the Receptionist’s deposit to allow for the fact that other employees at times cover this desk.

Use of individual cash drawers: It is imperative to proper internal controls that each employee be assigned their own cash drawer, with their own set amount of change. The drawers should have locking covers so when they are removed by the employee to store in the safe at night they can be kept intact. The actual counter drawers should also have locking features so that if the employee needs to step away from the work area, the drawer can be locked by that particular employee. This control would further ensure that each employee is responsible for their own cash. Shortages can be appropriately addressed with the

proper employee. This feature also serves to protect those not responsible for shortages which are a result of the work of others.

Response: New locking cash boxes have been provided to the Tax Collector and her Deputy, as well as to the Deputy Town Clerk. Locks have been installed in the drawers in the Tax Office. There is currently only 1 drawer in the Town Clerk's Office. We are investigating the cost of installing a second drawer. Locks will be installed in the drawers in the Clerk's Office once a decision has been made with respect to the second drawer. Locking cash boxes and locking file cabinets have been provided to the Transfer Station attendant and the Recycling Center Manager.

Cash up procedures in the Tax Collector's office: In all cases, when preparing the cash receipts for deposit, it is best practice to always deposit all cash receipts from the given day in the evening before closing the office. The cash and checks should be counted by the individual employees and reconciled to their work outlined in reports printed from the cash receipting software. The reports should be run by employee, and each individual employee should cash up their own individual drawers. All cash and checks received for that day should be included in the deposit, with only the original funds being left in the drawer. Any cash overages or shortages for the day should be noted on the cash up sheet for proper posting by the bookkeeper. Also, if mistakes are noted with particular transactions, i.e. a customer paid too much or too little, it should be addressed immediately by either voiding the transaction and returning the funds to the customer (generally in the case of a short), or by including the entire amount in the deposit but alerting the bookkeeper that a refund is due a particular customer (generally in the case of an overpayment). In no case should the difference be set aside for a future day.

Response: Same day depositing of cash receipts is required of all cash handlers, except the Recycling Center Manager who sporadically receives universal waste receipts which are addressed in a later comment. Each cash handler has their own cash box and reconciles their cash on hand, after subtracting the petty cash amount, to the "by clerk" reports printed from the cash receipting software. Each cash handler is responsible for promptly reporting any difference to the bookkeeper for recording via journal entry.

Interest charged on delinquent property taxes in the Tax Collector's office: We noted a number of instances in which judgment was used in determining how much interest should be charged on a delinquent property tax. For example, if a check came by mail, and the amount was not for the exact amount of the interest, the amount might be adjusted to the amount that would have been due based on the postmark date, or earlier. We noted a number of instances in which we are unsure how the amount of interest was actually calculated. Although individual amounts appear to be small, we feel it is important to have a set written policy with respect to how and when interest charges can be waived. The policy should spell out what is up to the discretion of the collector, and what would need Selectmen approval. Periodically, perhaps at least twice a year, we recommend that the Treasurer review interest charges to ensure that the policy is being followed as intended.

Response: It has been emphasized to the Tax Collector that the correct procedure is to calculate interest on all delinquent taxes through the date of receipt (which with respect to mail receipts is the postmark date) and to apply any payment to interest first. We agree that collection of small amounts of interest remaining due as a result of payments mailed in late without the inclusion of interest is unduly burdensome. We have been informed by MMA, however, that waiver of these amounts is not legal. In the absence of an alternative, we will seek to collect these amounts.

The Treasurer will review interest charges at least twice a year to ensure that the procedure is being followed as intended and will document the results of that review for the Board.

Under paid property tax amounts in the Tax Collector's office: In addition to a policy with respect to interest charges for property taxes, we recommend the Town establish a policy to write off certain very small amounts at least once a year. This would not be intended for amount to be abated, but rather would cover situations in which small underpayments exist in the accounting records that are not worth the Town pursuing.

Response: We agree that efforts to collect small amounts may not be cost beneficial, however, we have been informed by MMA that waiver of collection is unlikely to be legal. In the absence of an alternative, we will seek to collect these amounts.

Cash receipts: When observing cash collections at the Town Clerk's counter, it was noted that a separate manual receipt record was maintained for every transaction for the day. Although this system did seem redundant, we understand it provides useful information for the Clerk's office regarding the transaction types and amounts. However, this manual system should not replace the important step of entering the transaction into the computer when the transaction is taking place. We noted several instances when the transaction was set aside and entered into the computer system at a later time, once the customer had left. Control over the cash receipt is established when it is entered into the computer system. We would recommend the Town consider installing a second computer terminal at the Town Clerk's counter to allow dual input thus avoiding the practice of waiting and entering the receipt later.

Response: Immediate entry of transactions and the generation of Treasurer's receipts is a key control. The situation in the Town Clerk's office arises only when two individuals in the office are simultaneously receiving cash. There are 3 computers currently in the office, only one of which is at the counter. A full screen of the Treasurer's Receipt can be printed from the desktop computers. Alternatively, a small receipting printer can be connected to one of these computers. Until such time as a decision as to the installation of a second computer at the counter is made, the Town Clerk's office has been instructed to input transactions as soon as the computer is available.

Segregation of duties and system access: The Town's current software package allows for password use in entering certain accounting modules within the system. In establishing and maintaining proper segregation of duties, it is imperative that certain individuals don't perform certain incompatible functions. In addition to assigning functions properly, controls should be set in the software itself such that certain individual cannot even access certain functional areas. We would suggest that cash receipting stations are prohibited from anything but a read only access to any general ledger functions other than the treasurer and tax receipting modules. In addition, no one other than the bookkeeper should have access to the general ledger system to actually prepare and post general journal entries. In addition, the current Treasurer performs many oversight responsibilities that provide controls not often seen in a smaller Town environment. In order to have the Treasurer continue to serve this important function, we would recommend that she not be given access to any software except in a read only capability. This way, the role is truly oversight, and would not lapse into a situation in which she is reviewing her own work.

Response: Software controls have been set to preclude anyone other than the bookkeeper from accessing the general ledger. The Treasurer does not have access to the computerized accounting system at all, however, if the system is installed on the Treasurer's computer in the future, it will provide read-only access.

Bookkeeping/journal entries: The process of making journal entries to correct errors or to post unusual transactions is a common bookkeeping function. Based on our review, it appears the use of journal entries is appropriate. However, because journal entries can be a way in which management can override their own internal control systems, it is imperative that journal entries be reviewed and approved by someone other than the preparer. Additionally, adequate documentation should be maintained in the journal entry book or file so that when reviewing history, a proper audit trail is provided. We would recommend that the journal edit be printed and initialed by the Treasurer or Administrator prior to posting, and that any relevant backup be maintained in the file.

Response: The bookkeeper maintains a binder in which all journal entries are filed. Journal entries are of two types (1) entries arising from the bank reconciliation process, e.g. electronic deposits from the State, checks returned for insufficient funds, and (2) corrections and/or reclassifications of earlier entries. As the Treasurer prepares the bank reconciliation, all entries resulting from it are reviewed and initialed by the Town Administrator prior to their recording by the bookkeeper. Corrections and or reclassifications will be initialed by the Treasurer prior to their recording.

Bringing actual deposit to banking institution: If proper cash up procedures are performed such that the deposits are being made intact daily after being properly reconciled to transaction reports, the act of bringing the deposit from the Town Office to the banking institution does not necessarily need to be performed by the individuals responsible for the various collection offices. In fact, once the deposits are prepared and placed in a locked bag, any responsible party can perform the “courier” function. Some organizations even utilize an outside courier service to perform the task. The current practice of both office representatives traveling to the bank independently seems redundant. We would recommend that at a minimum the task is shared on a rotational basis.

Response: We will investigate the possibility of using a responsible party other than the Town Clerk and Tax Collector to take the day’s deposits to the bank. In the meantime, the Town Clerk and Tax Collector may rotate this task on a weekly basis.

Policy manual: It was noted that the Town has a number of good policies, all of which are maintained in a policy notebook. We did note however the absences of at least one important policy which we feel the Town should consider adopting – an investment policy. In reviewing current deposit and investment practices, we have no immediate concerns, however a written policy will provide guidance to future administrations and provide for controls and limits on such things as credit risk tolerance, concentration limitations, and interest rate risk (maturities).

Additionally, we would recommend that the policy book be consistently maintained by providing the dates the policies were adopted or amended on every policy page. It also should note whether the policy was adopted at the Town meeting level, the Selectmen’s level, or simply adopted as best practices by the Town’s administration.

Response: It is the intent of the Board of Selectmen to continue with the Town’s highly conservative practice of investing only in cash, certificates of deposit and money market accounts, all of which are fully collateralized.

Going forward, the Town’s Policy Manual will indicate the date of adoption or amendment of each policy, as well as the level at which each policy was approved.

Recycling Center petty cash: Petty cash at the Recycling Center does not appear to be physically controlled. We would suggest that it be maintained in a locked box in a locked cabinet or drawer. This is especially important because the office is not consistently occupied, and the attendant often has to leave the office unattended for periods of time. As with any petty cash system, responsibility should be assigned to one individual and only that individual should maintain keys for access. Also, with respect to universal waste receipts, we understand that although the cash is brought to the Town Office nightly, it is not “cashed up” and deposited on a regular basis. We did note that the amounts are often small on a daily basis, but would recommend that a consistent practice be established by means of a written policy. For example, a policy might be adopted that calls for receipts to be cashed up weekly, every Wednesday, unless they exceeded a certain threshold in which case a cash up would be required on the day that the funds on hand exceed the established limit. In any case, cash should be counted daily before funds are brought to the Town Office, and a record of balances should be maintained.

Response: A cash box with a locking cover and a locking file cabinet has been obtained for the office of the Recycling Center Manager. A policy requiring the weekly depositing of cash received by the Manager, generally universal waste receipts, has been drafted.

Transfer Station: The Transfer Station currently allows employees and others to remove items for re-use that other individuals have left behind. We do understand the value of this type of “recycling” such that items are eliminated from the trash stream. However, there is no apparent tracking of this practice. We feel the Town should adopt a policy with respect to what is allowed in this area and what practices would be discouraged. Additionally, a log should be maintained to track items that are removed by employees or others. This log should be periodically reviewed by the Selectmen to ensure they are comfortable that this practice is consistent with the adopted policy.

Response: A policy with respect to removal of items from the Recycling Center and Transfer Station has been drafted. The Recycling Center Manager and Transfer Station Attendant will keep logs of items removed beginning February 15, 2006. The logs will be reviewed weekly by the Town Administrator to determine if modifications to the draft policy should be made. Upon formal acceptance of the policy by the Board of Selectmen, the Recycling Center Manager will forward copies of the logs to the Administrator on a monthly basis or as requested.

Petty cash policy: It appears the current petty cash policy maintained in the policy book is in need of updating. Amounts, locations and custodians should be spelled out in the policy and updated as necessary over time.

Response: The petty cash policy has been updated to reflect current custodians, locations and amounts the updated policy was adopted February 16, 2006.

General ledger: The current practice is that the Town maintains one fund in its general ledger to account for all activity of the Town. Although this may be adequate, it is often useful for a Town to adopt a fund accounting system which is consistent with the reporting required in the annual financial statements. Funds with special restrictions, such as special revenue funds or capital projects, can be tracked separately from other general operating revenues and expenditures, in a separate self balancing group of accounts. This type of system can assist management in a variety of ways, one being that the Town would have the ability to quickly ascertain fund balance position in the general operating fund without having the restricted revenues and expenditures distorting the overall general fund picture.

Also, with respect to the Town's current chart of accounts, we noted a number of accounts no longer being used. These accounts should be eliminated to avoid unintended postings. Also, when establishing new accounts, account numbers should be assigned in an order that is consistent with proper accounting – that being assets, liabilities, and fund balance accounts – in their order of liquidity. Finally, with respect to accounting for grant funds, in no case should grant revenues be “netted” against grant expenditure in the same account. All revenues should be posted to proper revenue accounts and all expenditures to proper expenditure accounts. The current accounting system set up (i.e. no separate funds) would require the tracking of net grant balances on separate manual spreadsheets, which we understand is currently the practice.

Response: The Town Administrator, Treasurer and Bookkeeper will review the current chart of accounts and eliminate those not being used. We are also aware that in certain instances the Appropriation Control Report does not easily correspond to the presentation used in the Town Meeting Warrant and we will make modifications as seem practicable. Modifications and additions will follow the standard practice outlined above. We will consider the practicality of adopting a fund accounting system and do so if it appears the benefits outweigh the risk of error and the cost.

Bank reconciliations: We understand the practice of monthly bank reconciliations has become a priority for the Town and we commend the practice of performing this task within days of receiving the information from the banking institution. We would recommend that if any differences arise from this reconciliation process, that journal entries be posted promptly to correct the amounts such that they do not repeat on subsequent bank reconciliations.

Response: In connection with the audit of the Town's financial statements, journal entries were made to adjust for reconciling items which had appeared on the bank reconciliation since 12/31/2003. In February, 2006, a journal entry was made to adjust for reconciling items which arose during 2005, most of which represented checks returned for insufficient funds.

General accounting training and oversight: The Town currently has a number of significant positions that perform a number of critical accounting functions for the Town. This would include the Tax Collector, Town Clerk, Treasurer and Bookkeeper. These positions require a great deal of skill and training in order for individuals to become fully proficient. As is the risk with any position, turnover can result in problems if others within the organization are not familiar with the procedures, tasks and practices. The Town might consider whether they could benefit from a full or part time finance professional to provide oversight and guidance in all of these areas, as well as to provide support to the Town Administrator and the Selectmen. It should be noted that currently the Town enjoys the benefit of the Treasurer performing a number of these functions.

Response: The 2006 budget includes compensation for a deputy Town Administrator. In reviewing candidates for this position, the Board of Selectmen may designate this person to be the primary overseer and guide for the finance and accounting functions. Alternatively, the Board may designate the Treasurer continue in these roles.